No. 7099

IN THE

United States Circuit Court of Appeals

FOR THE

Ninth Circuit

SECURITY BUILDING & LOAN ASSOCIATION, a Corporation, and BEN H. DODT, Receiver of Security Building & Loan Association, a Corporation,

Appellants,

vs.

JOHN H. SPURLOCK, TED DEMPSEY, W. N. SELMAN, MARY ROSE, RAY L. ROSE, JOE RAMOS, LILLIAN M. ERWIN, LUTHER M. FRINK, E. DALE FRINK, JOHN H. DIGGES, BILLIE LIEBER, HATTIE M. LIEBER, HATTIE SCHNEIDER LIEBER, HENRY F. LIEBER, HENRY LIEBER, JR., HERMAN LIEBER, and R. E. L. SHEPHERD, Receiver in Bankruptcy,

Appellees.

PETITION OF APPELLEES, MARY ROSE, RAY L. ROSE, JOE RAMOS, LILLIAN M. ERWIN, LUTHER M. FRINK, E. DALE FRINK, JOHN H. DIGGES, and R. E. L. SHEPHERD, Receiver in Bankruptcy, for Rehearing.

ALICE M. BIRDSALL,
THOMAS W. NEALON,
Counsel for Petitioning Appellees.

CASES CITED

CASES CITED (Cont.)

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Appellees.

APPELLEES' PETITION FOR REHEARING

Come now Mary Rose, Ray L. Rose, Joe Ramos, Lillian M. Erwin, Luther M. Frink, E. Dale Frink, John H. Digges, and R. E. L. Shepherd, Receiver in Bankruptcy, Appellees in the above styled and numbered cause in which, on the 6th day of June, 1933, this Court rendered

its decree reversing the order of the District Court of the United States in and for the District of Arizona, which decree of the said District Court of Arizona adjudicated the Security Building and Loan Association a bankrupt, and within the time for filing a petition for rehearing these petitioners file this, their petition for such rehearing and for grounds thereof respectfully represent:

FIRST

That the Court erred in not granting Appellees' Motion to Dismiss the appeal upon the grounds set up in said Motion of Appellees to Dismiss said Appeal, and particularly upon the ground that the Trustee in Bankruptcy was a necessary and indispensable party to said appeal, no supersedeas having been filed on appeal from the Decree of Adjudication, and not having been made a party, and no severance having been sought or granted, this Court was without jurisdiction to hear said appeal for lack of necessary parties.

AUTHORITIES:

Davis v. Mercantile Trust Co., 152 U. S. 590, 38 L. Ed. 563, 14 Sup. Ct. Rep. 693;

Wilson v. Kiesel, 164 U. S. 248, 41 L. Ed. 422, 17 Sup. Ct. Rep. 124.

SECOND

That the Court erred in holding that the Security Building and Loan Association was

(1) A building and loan association de jure within the meaning of the laws of Arizona; and

(2) That it was so declared to be by the appropriate officers of the state,
for the following reasons:

(1) That a de jure corporation being defined as one which is invulnerable in quo warranto proceedings instituted by the state, and to constitute which every substantial requirement of the law under which it is incorporated must be complied with, it follows that a de jure building and loan association within the meaning of the laws of Arizona must be one so organized under the laws of Arizona as to be invulnerable in quo warranto proceedings brought by the state, and to be shown to have complied with every substantial requirement of Article 4, Chapter 14, Revised Code of Arizona 1928.

The organization of the Security Building and Loan Association as a building and loan association was fatally defective in the following particulars:

(a) Section 613 (Article 4, Chapter 14) Revised Code of Arizona 1928, provides the manner in which a building and loan association may be incorporated in Arizona, providing it shall make and file articles as for private corporations, and sets forth that such articles *shall* include (among other things) "the amount of the par value and the kinds of stock that the association *will* issue".

The kind of stock provided for in the Articles of Incorporation of the Security Building and Loan Associa-

tion does not come within the definition of building and loan stock as prescribed by Sections 612 and 618 of said Revised Code, in that the articles provide only for the stock of a non-mutual corporation and expressly forbid loans thereon or withdrawals thereon or the pledging thereof as security for the loan, thereby precluding the doing of a building and loan business in the manner provided for in Sections 612 and 618. It is axiomatic that under the provisions of Section 613 aforesaid all stock issues must come within the capital authorized in order to comply with the provisions of the general incorporating law, to-wit, Section 587, Subdivision 3, of the Revised Code of 1928. The provision in Article 6 of the By-Laws that "additional working capital may be accumulated by the issuance of membership shares, units and certificates, both installment and fully paid, as provided for in Chapter 76, Arizona Session Laws 1925, and the By-Laws of this corporation" is rendered inoperative and ineffective by reason of the fact that the authorized capital stock has been previously fixed in said Article 6 at fifty thousand shares of a par value of One Hundred Dollars, and the stock classified therein limits both the amount and kind of stock. There is no provision in the statutes of Arizona for the issuance of "units and certificates" and therefore that right cannot be created by incorporating the same into either the Articles or By-Laws of the association. The powers of the association could not exceed those enumerated in its Articles of Incorporation, and only those so enumerated as are warranted by the statutes in question; the Articles here not providing for such stock as is recognized as mutual building and loan stock, and

the authorized capital stock being limited to a particular stock, no recitals in the By-Laws can cure this defect in the Articles of Incorporation. It follows that the association cannot be a building and loan association de jure under the laws of Arizona.

(b) The permit to carry on the business of a building and loan association required by Section 614 (Article 4, Chapter 14) Revised Code of Arizona 1928, was never issued to such association prior to the completion of its organization, or at all, and consequently the requirement that such permit must be issued and recorded in the office of the recorder of the county of its principal place of business was not complied with, and the record conclusively shows that no such permit was ever issued or recorded. This is a "substantial requirement" of the law as it is a condition precedent to the doing of business. The *licenses* set up in the record as having been issued to this association by the Superintendent of Banks for periods of one year each and for which a fee of Five Dollars per year are charged have no connection with the requirements of Section 614. They are issued under the provisions of Section 220, Chapter 8, Revised Code of Arizona 1928, and are nowhere required to be recorded, nor were they in fact recorded in any county, or at all. The omission to comply with this statutory requirement was fatal to the organization of a building and loan association de jure.

(c) The By-Laws of the association were not adopted *nor recorded* in conformity with the requirements of Section 616 (Article 4, Chapter 14) Revised

Code of Arizona 1928, and do not fulfill the requirements of the provisions thereof in many respects, but notably in that nowhere do they provide for the *charges of management,* and for the periodical investigation of the business and condition of such association. The requirements of the statute with regard to the provisions to be contained in the By-Laws are fundamental and the compliance with same and with the requirement that they be recorded in the office of the county recorder where the principal office of the association is located is a condition precedent to the completion of the organization as a building and loan association, since the general incorporating law contains no such requirements with respect to private corporations. The purpose of the legislature in requiring the recording both of a *permit* from the Superintendent of Banks and of By-Laws in which all the essential features of the business structure under which an association proposes to operate are set forth is obvious, and these requirements for the benefit and protection of the public in giving notice to prospective investors and borrowers of the nature and set-up of the organization cannot be dispensed with.

Since the record conclusively shows that the By-Laws were never recorded, as well as showing the omission therefrom of statutory requirements, no building and loan association de jure could have existed.

(d) The requirement of Section 628 (Article 4, Chapter 14) Revised Code of Arizona 1928, with respect to the deposit of securities with the State Treasurer, reading as follows:

> "Before the superintendent of banks shall issue a permit to do business to any building and loan association, such association shall deposit with the state treasurer *securities of the character authorized for the investment of the funds of the association to the amount of fifty thousand dollars,* to be held in trust for the benefit of the stockholders or members of said association; or in lieu of the deposit of such securities, or part thereof, a bond in the amount of fifty thousand dollars, of a surety company qualified to do business within the state, etc."

was not complied with for the reason that the record shows that the attempted compliance with this requirement on the part of the association was the deposit of certificates of deposit of an aggregate value of Fifty Thousand Dollars on March 7th, 1929, and a (subsequent) deposit of four notes and mortgages in the aggregate sum of Ten Thousand Dollars. The character of the securities authorized for the investment of the funds of the association is specified in Section 618 of the Code, and includes (in addition to *loans* by notes secured by first mortgage on real property, or real property to be improved under contract with the association and on shares of the association to the amount of ninety per cent of their withdrawal value) ONLY the following: "Bonds of the United States, the state of Arizona, counties, school districts and other municipalities, and of improvement districts in said state". Clearly, therefore, the certificates of deposit were not a deposit in compliance with the statute, since they were not securities authorized by the

clear language of the statute, and since the deposit of securities of the character authorized by the statute was a condition precedent to the issuance of a permit to do business to the association by the superintendent of banks, it follows that this very "substantial requirement" of the statute necessary to perfect an organization de jure was not complied with. The approval or non-approval of these securities by the bank examiner could carry no weight as the statute does not permit or authorize him to approve such securities, but *only the bond* which may be substituted in lieu thereof; neither is he vested with any discretion to vary the terms of the plain letter of the statute as to the character of these securities. And if it be contended that the defect was cured by the substitution on October 9, 1929, of a bond in the sum of Fifty Thousand Dollars, it could scarcely be urged that the condition precedent was complied with, since the Certificate of Incorporation was issued to the association (by the Arizona Corporation Commission under the general laws of Arizona) on September 5, 1929, thus precluding the organization of a de jure building and loan association.

(e) The right to do a building and loan business was a special or secondary franchise independent of the formation of a corporation. This, being a special or secondary franchise, does not vest until there has been bona fide acceptance by actual user thereof. The evidence in this case conclusively shows non-user as well as mis-user of this franchise in that no building and loan business was ever done. It is the rule that for non-user or mis-user, quo warranto proceedings by the State will lie, and for

this reason the Security Building and Loan Association could not be a building and loan association de jure within the accepted meaning and definition of a de jure organization.

(2) There is no provision in the statutes of Arizona authorizing any particular officer of the state to pass upon or declare any organization or corporation to be a building and loan association, and in the absence of an express statute any certificate of any officer to that effect would be wholly without force or weight. However, the record shows no declaration by any officer to that effect.

The Superintendent of Banks by Section 614 only passes upon the question of whether the incorporators are financially responsible and there is need in the community for the organization of a building and loan association. On this one point his decision is not subject to appeal, and he may thereupon (if satisfied) "issue a permit" to carry on the business of a building and loan association. Since this is before the completion of the organization, certainly this language could not be construed to mean that the issuance of such permit is a "declaration" that any organization not yet completed is a building and loan association. Furthermore, as pointed out above, this permit was *never issued* and therefore could never have been recorded in compliance with the statute.

Certainly there is no "declaration" or even implication by the Certificate of Incorporation issued to this Association by the Corporation Commission that this asassociation is a building and loan association. The re-

cord shows the Certificate to be a certificate reciting the qualification of the Security Building and Loan Association *as a private corporation under the general laws of Arizona,* and this certificate was not issued until September 5, 1929, which was many months after the purported organization of the building and loan association. But, in any event, the recognition of the corporation as a building and loan association by the Superintendent of Banks or the Corporation Commission or any other officer, *unless authorized by law so to do,* would be of no effect and could in no way cure the defects in its organization. Nowhere in the statute can be found any authority granted to any officer of the state to pass upon or certify the sufficiency or validity of the organization as a building and loan association.

AUTHORITIES

(1.) That a corporation de jure is one invulnerable even in direct proceedings brought against it by the state:

7 *R. C. L., Sec.* 42, page 60; sec. 45 page 64;

14 *C. J., Sec.* 215, page 204;

Kosman v. Thompson, Judge (Iowa), 215 N. W. 261;

Capps v. Hasting's Prospecting Co., 40 Neb. 470, 58 N. W. 956, 42 A. S. R. 677, 24 L. R. A. 259;

Alderslope Ditch Co. v. Moonshine Ditch Co., 176 Pac. 593;

In quo warranto proceedings by state on right of

corporations to exercise corporate powers, corporation must show existence de jure and therefore a *substantial* compliance with *all* the conditions precedent to legal incorporation prescribed by statute.

14 *C. J., Sec.* 281, page 251.

Fletcher Cyc. Corp., Vol. 1, Sec. 182

Bank of Midland et al. v. Harris, 114 Ark. 344, 177 S. W. 67, Ann. Cas. 1916B 1255.

Whether the things done in and about the organization, when done, constitute a legal corporation is a question of law.

Fletcher Cyc. Corp., Vol. 1, Sec. 182

As to what is substantial compliance with statutory requirements.

People v. Golden Gate Lodge No. 6 B. & P. O. of Elks, (Cal.) 60 Pac. 865.

Bank of Midland v. Harris, 114 Ark. 344, 170 S. W. 67, Ann. Cas. 1916B, 1255.

The By-Laws of a corporation cannot aid or enlarge the limitations of the Articles, especially in regard to the capital stock.

Chicago City Ry. Co. v. Allerton, 85 U. S. (18 Wall. 233), 21 L. Ed. 902,

wherein it is said:

"A corporation * * * is an association of natural persons who contribute a joint capital for a common purpose and although the shares may be assigned to new individuals in perpetual succession, yet the number of shares and amount of capital cannot be increased, except in the manner expressly authorized by the charter or articles of association. * * * Changes in the purpose and object of an association or in the extent of its constituency or membership, involving the amount of its capital stock, are necessarily fundamental in their character and cannot on general principles be made without the express or implied consent of the members."

Failure to file articles with county clerk fatal to corporation de jure.

Martin v. Dietz, 102 Cal. 55, 36 Pac. 368, 41 Am. St. Rep. 151.

And where Illinois statute required that as part of proceedings for incorporation a report setting up various matters relating to stock subscriptions, et cetera, should be filed with the Secretary of State, who thereupon should issue a certificate of complete organization of the corporation, the failure to record such certificate of the Secretary of State was held to be fatal defect.

M. H. Vestal Co. v. Robertson, 277 Ill. 425, 115 N. E. 629.

It must be borne in mind that the Arizona statute not only requires a permit to do business as a building

and loan association to be issued by the Superintendent of Banks prior to the completion of the organization, and recorded in the office of the recorder of the county where the principal business is located, but also requires the By-Laws to be recorded, and that the Security Building and Loan Association failed to comply with either of these requirements.

That corporate existence can be questioned in quo warranto proceedings for non-user and mis-user of franchise.

Cook on Corporations, 7th Ed., Vol. 2, Sec. 634, page 1941;

22 R. C. L., Sec. 11, Page 672, et seq.;

Chicago Life Ins. Co. v. Needles, 113 U. S. 574, 28 L. Ed. 1084;

People ex rel Attorney General v. Dashaway Association, 84 Cal. 114, 12 L. R. A. 117;

Woods v. Lawrence 66 U. S. (1 Black. 386) 17 L. Ed. 122.

(2) The certificate of an officer of the State is not evidence of corporate existence unless made so by statute.

"Unless the governing statute empowers the particular officer of the State to determine that the provisions of the law have been complied with, his certificate to that effect is not evidence of the fact, but it must otherwise appear."

14*C. J. Sec.* 174, page 172;

In *Boyce v. Towsonton Station M. E. Church,* 46 Md. 359, where the law provided that in incorporating religious societies, churches, etc., an agreement should be signed and acknowledged by trustees before two Justices of the Peace or before Judge Circuit Court, etc., and which should be certified by the said Justices or Judge *according to directions of section,* it was held that no authority having been given to the Judge to determine that the provisions of law have been complied with, his certificate to that effect is not evidence of the fact and the court refused to admit it in evidence.

"An ex parte certificate or statement by a public officer is not evidence of the facts stated unless made so by law."

Farmers' State Bank v. Brown, 204 N. W. 673.

That officer empowered by statute to issue license to do business for current year and collect fee therefor, acts in ministerial capacity and has no power to pass upon legality of organization, See

Westlake Park Inv. Co. v. Jordan (*Cal*), 246 Pac. 807.

THIRD

That the Court erred in holding that the Security Building and Loan Association comes within the excep-

tion of the Bankruptcy Act adopted in February, 1932, for the reason that the evidence conclusively showed that it not only had failed to organize as a building and loan association under the definition thereof prescribed in the Arizona statute, but that no building and loan business was ever transacted by it, and under such construction of the exception, it would inevitably follow that in order to evade the provisions of the Bankruptcy Law, it will only be necessary for promoters of a corporation to set up in their Articles of Incorporation that they propose to do the business of a building and loan association and secure a license by paying the fee therefor and thereafter engage in any other business—mercantile, trade, or even gambling—and yet claim exemption from the penalties and liabilities under the Bankruptcy Act by merely setting up that they are *chartered* to do a building and loan business. This construction of the Act will open the way to all kinds of fraud, and we believe is not in accord with the universal application of the principal that it is the business actually done that controls the exemption from the Bankruptcy Law and not what a corporation may be empowered to do. No case has been cited, nor, so far as we can discover, can be cited to the contrary. The Clemons case is not in point, because the question there determined was whether the corporation could claim exemption through its ultra vires acts.

Furthermore, such construction precludes a uniform interpretation of the meaning of the words in the exception (Amendment of February, 1932) and would result in confusion in determining what organizations may

come within this exemption in the law, in the different states, the District of Columbia, and each of the various territories.

AUTHORITIES

That the business actually engaged in by those claiming the benefits of the exemptions to the provisions of the bankruptcy act controls, and this is true of corporations as well as individuals and other companies.

> "The liability of a person whether natural or artificial to bankruptcy is to be judged by the character of the pursuit in which such person was engaged at the time the debts due the petitioning creditors were incurred, with respect to which it may be conceded that as to a corporation its actual business is to be considered and not that which it might possibly have undertaken by virtue of authorized but unexercised powers.

Tiffany v. La Plume, 141 Fed. 444, 448.

> "It is the actual occupation of the corporation not its charter purposes that governs where there is a conflict as to occupations, though of course the charter provisions may be looked to as an aid to the determination".

Remington on Bankruptcy, Third Ed., Vol. 1, Sec. 92.

In re Supreme Lodge of Masons Annuity, 286 Fed. 180;

In re Jutte Co., 266 Fed. 357;

Friday v. Hall & Kaul Co., 216 U. S. 449, 54 L. Ed. 562;

Toxaway Hotel Co. v. Smathers & Co., 216 U. S. 439, 54 L. Ed. 558.

In the latter case it is said:

> "Liability under the act is dependent upon what it was actually doing rather than upon what it was organized to do or professed to be doing."

While it is true these decisions were rendered under the law prior to 1910, and deal with corporations "principally engaged" in certain business, they are none the less in point as showing that charter provisions and authority thereunder have not been held determinative of the business when exemptions are claimed under the act.

And by analogy, the following cases holding that charter provisions fixing the principal place of business do not control are submitted as being in point:

Guanacevi v. Tunnel Co., 201 Fed. 316;

Home Powder Co. v. Geis, 123 C. C. A. 94, 204 Fed. 586.

Also analagous as showing the application of the principle that the business engaged in, not the provisions of its charter, controls in fixing the character of a public utility corporation, are the following decisions of the Supreme Court of the United States:

U. S. v. Brooklyn Eastern District Terminal, 249 U. S. 296, 63 L. Ed. 613;

Terminal Taxicab Co. v. Kutz, 241 U. S. 252, 60 L. Ed. 984.

The latter case has been cited with approval in a recent decision of the Supreme Court of Arizona (*Claypool v. Lightning Delivery,* 38 Ariz. 262, 299 Pac. 126), wherein the court used the following language:

> "So in this, as in any other similar case, it is the general conduct of the actual business and not isolated acts, public or private, which fix the character of a common carrier on a party. And no form of subterfuge or evasion will prevent the courts from going behind the form to the substance." (*Italics ours*).

FOURTH

That the Court erred in not making order with respect to the taxing of costs, because no costs should or could have been taxed against appellees for the reason:

(1) That Appellant B. H. Dodt, as Receiver appointed by the State Court was not an indispensable or necessary party to the appeal, and did not, and could not as such receiver, pay or incur any of the costs thereof.

(2) That the Appellant Security Building and Loan Association, having admitted its insolvency and the commission of an act of bankruptcy prior to the Amendment under which it claims exemption from the operation of

the Bankruptcy Act, and having surrendered all of its assets to the Receiver appointed by the State Court, could not pay any of said costs, nor recover them herein.

(3) That the appeal being directed against R. E. L. Shepherd, in his capacity as a Receiver appointed by the Court at a time when the alleged bankrupt was admittedly subject to adjudication, the costs, if any assessed, should be against the estate that came into his hands as such Receiver.

(4) That no supersedeas bond having been given and a trustee having been appointed by the Court, and he not being made a party to these proceedings, and the Court having admittedly had jurisdiction to declare the alleged corporation bankrupt at the time the petition was filed, no costs should have been taxed against the petitioning creditors, they being merely the representatives of all the creditors.

(5) That this is a proper case for the exercise of the discretion of the Court in requiring the parties to the appeal to pay their own costs, the common rule being that when a proceeding is dismissed for want of jurisdiction, neither party recovers costs.

AUTHORITIES

The common rule is that when a proceeding is dismissed for want of jurisdiction, neither party recovers costs.

In re Jourdan, 111 Fed. 726 (C. C. A.) Mass., 55

L. R. A. 349;

Citizens Bank v. Cannon, 164 U. S. 319, 41 L. Ed. 451;

Nashville v. Cooper, 73 U. S. (6 Wall. 250), 18 L. Ed. 851;

Hornthal v. Keary, 76 U. S. 560-567, 19 L. Ed. 560.

The Court may decline to assess costs on appeal against petitioning creditor.

In re McCrae, 161 Fed. 246, 20 L. R. A. (N. S.) 246. (2nd C. C. A.)

The Court should not assess costs against an officer of the Court defending the possession of the Court.

In re Jourdan, 55 L. R. A. 349, 111 Fed. 726 (C. C. A.) Mass.

WHEREFORE, premises considered, Mary Rose. Ray L. Rose, Joe Ramos, Lillian M. Erwin, Luther M. Frink, E. Dale Frink, John H. Digges, and R. E. L. Shepherd, Receiver in Bankruptcy, Appellees as aforesaid, pray that a rehearing be granted herein, and that on such rehearing the motion of Appellees herein to dismiss the Appeal prosecuted to this Court from the District Court of the United States for the District of Arizona be granted or, in the alternative, that this Court render judgment affirming said judgment of the District Court of the United States for the District of Arizona adjudicating the Security Building and Loan Association

a bankrupt, and for such other and further relief as may be meet in the premises.

Alice M. Birdsall

ALICE M. BIRDSALL,

Attorney for Appellees Mary Rose, Ray L. Rose, Joe Ramos, Lillian M. Erwin, Luther M. Frink, E. Dale Frink and John H. Digges.

Thomas W. Nealon

THOMAS W. NEALON.

Attorney for R. E. L. Shepherd, Receiver in Bankruptcy.

UNITED STATES OF AMERICA)
DISTRICT OF ARIZONA)
STATE OF ARIZONA) ss.
COUNTY OF MARICOPA)

I, Thomas W. Nealon, one of the counsel in the above styled and numbered cause, do certify that I believe there is merit in the foregoing petition for rehearing, and that the same is not filed for delay.

Thomas W. Nealon

THOMAS W. NEALON.

Before me, the undersigned authority, on this day personally appeared Thomas W. Nealon, counsel for

Appellee R. E. L. Shepherd, Receiver, who, upon oath says that there is in his opinion merit in the foregoing petition for rehearing, and that the same is not filed for delay.

Thomas W. Nealon

THOMAS W. NEALON.

Subscribed and sworn to before me this 29th day of June, 1933.

My Commission expires June 18, 1935.

Bess M. White

BESS M. WHITE,

Notary Public in and for the County of Maricopa, State of Arizona.

APPENDIX

Section 587 (subdivision 3) Revised Code of Arizona 1928.

The Articles shall contain * * * * * * 3. the amount of capital stock authorized and the time when and the conditions upon which it is to be paid in. The articles may provide for the issuance of one or more classes of stock and stock without par value, in such number of shares, with such rights, and preferences, as shall be stated in the articles; that the issuance and sale of shares without par value will be for such consideration as is prescribed in the articles; that shares without par value shall be deemed fully paid and non-assessable;

Section 220, Revised Code of Arizona 1928:

Licenses; private banks prohibited. The superintendent shall prepare and furnish to every building and loan association or bank doing business in this state a license authorizing said institution to use the name and transact the business of such institution during the fiscal year of issuance thereof, and to each new building and loan association or bank which shall have been by him approved to do business in this state as hereinafter provided a license for the unexpired portion of the fiscal year in which such license is issued. Any building and loan association or bank transacting the business pertaining to such institution without securing such annual or other license as above provided shall pay a fine of fifty dollars for each day of such default. The superintendent shall receive five dollars for each license issued under the provisions of this section. No license shall be issued to private or partnership banks and their establishment or maintenance is prohibited.